

JUL - 9 2008

CERTIFIED MAIL, RETURN RECEIPT REQUESTED

Ms. Deann Hapner
Vice President
Pacific Gas and Electric Company
P.O. Box 7442
San Francisco, CA 94120

Dear Ms. Hapner:

This letter is in reference to the Grid Management Charges ER01-313-000, *et al.* Having reviewed the D.C. Circuit Court Opinion in *Western Area Power Administration v. FERC*, Case No. 04-1090, *et. al.*, the Western Area Power Administration (Western) provides this letter to notify PG&E that it must withdraw its invoice to Western for the disputed Grid Management Charges (GMC) and refund the \$8,297,031.03 Western previously paid for the GMC, plus interest.

In PG&E's FERC filings, PG&E identified two separate and distinct arguments for its authority to pass through the GMC to Western. On one hand, PG&E argued the GMC was either a rate increase permitted under existing contracts or, in the alternative, the GMC was a new service that PG&E offered under its Pass-Through Tariff (PTT). Initially, Western paid the GMC invoices, subject to refund, under recognition that PG&E sought to recover the GMC as a rate change under existing contracts. However, in November 2003, PG&E amended its FERC case to voluntarily dismiss its first argument seeking to recover the GMC as a rate change under existing contracts. As a result, PG&E elected to only pursue recovery of the GMC as a charge for new services offered under its PTT. Therefore, PG&E's only remaining argument is that it has authority to recover the charges because they are new services that PG&E offered under PG&E's PTT.

As you are aware, Western and PG&E have disputed, and were in litigation to determine, whether the Grid Management Charges were for new services. The recent opinion issued by the United States Court of Appeals for the District of Columbia Circuit in *Western Area Power Administration v. FERC* affirmed that the GMC are charges for new services. Specifically, the D.C. Circuit Court held the two applicable components of GMC, the Control Area Service Charge and the Market Operations Charge, are entirely new services provided by the California Independent System Operator.

Western, a Federal agency, however, never accepted these new services, did not execute a contract for these new services and, indeed, expressly rejected the new services. In order to invoice a Federal agency, PG&E needs to establish that a Federal contracting officer executed a contract for the new

services. Such contract provides the legal obligation for the Federal Government to pay. PG&E cannot do this. Western refers you to Western's June 12, 2006, letter denying PG&E's claim for a more detailed explanation.¹ Therefore, PG&E must withdraw the invoice for these new services and refund the monies Western paid, with interest.

With this letter, Western does not waive any legal rights or defenses it may have regarding PG&E's ability to charge Western for the new services offered under the PTT.

If you have any questions or concerns, please do not hesitate to contact me at (916) 353-4421.

Sincerely,

Sonja A. Anderson
Power Marketing Manager

¹ Because PG&E is unable to certify and verify that the GMC invoices are submitted under a Federal contract, Western is not now seeking information from PG&E regarding its GMC invoices. If a tribunal with controlling jurisdiction holds that Western is required to pay the GMC charges, Western and PG&E then would need to resolve the following disputes regarding the invoices: (1) provide the billing determinants for specific customers; (2) identify under what authority PG&E is calculating interest and on what date the interest charges begin to accrue; (3) explain PG&E's treatment of the GMC for the following customer loads: NCPA, SVP, SMUD, MID, THD, DOE, and Lassen; (4) identify the charges for Contract 2207A loads and charges, if any, for Contract P0004; (5) accounting for Central Valley Project (CVP) generation as it relates to PG&E's GMC invoices; (6) accounting for loads connected to the CVP transmission system as it relates to PG&E's GMC invoices; and (7) PG&E should eliminate any charges to Western for the Market Operations component of the GMC based on the D.C. Circuit Court's recognition, and FERC's representations in the administrative record and in oral arguments and PG&E's own witnesses' testimony, that each entity's Market Operations charge will be reduced by that entity's self-provision of ancillary services.